Deloitte.

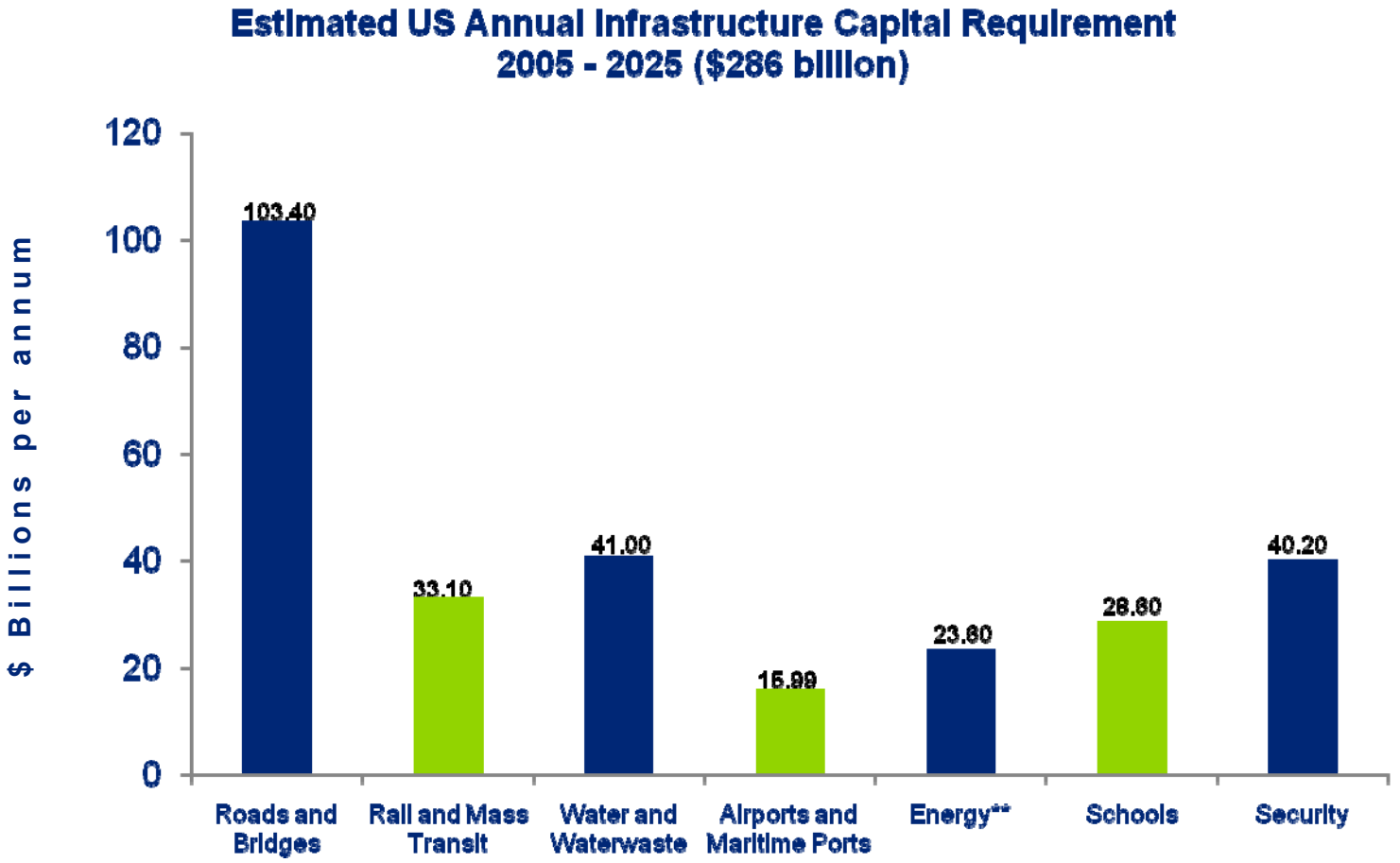
Public Private Partnerships for California
Bridging to the future

Presentation to the Little Hoover Commission
Sacramento, March 26 2009

The US Infrastructure landscape

	Public (and "non-profit")	Public/Private	Private
Surface transportation	most	some	
Ports		some	some
Aviation		all	
Freight rail			all
Power/Energy	some		most
Healthcare	most		some
"Social" (Education/corrections)	all		
Telcoms			all
Water/Wastewater	most		some

US Infrastructure needs



Source: ASCE, Report Card for America's Infrastructure, 2005

** US Department of Energy. *Department of Energy Requests $23.6 Billion for FY 2007. *February 6, 2006

The genesis of PPP - common international themes:

1. Substantial gap between needs and resources
2. Dissatisfaction with short-term budgetary thinking and the lack of accountability for long-term consequences
3. A desire to secure financing for public infrastructure using methods that are off-balance sheet to the central government
4. A belief in the value of optimizing risk allocation and whole-life costing

Snapshot of US PPP to date

- A modest but growing number of transactions evenly split between monetization and new development , mostly in surface transportation
- California early examples: Route 91 Express Lanes and the South Bay Expressway (SR 125); contemporary projects: AOC, and LA Metro
- More than half the States have passed enabling legislation; Virginia, Florida, Ilinois and Texas have been the leaders
- Private sector participants are largely non-domestic: Spanish and Australian firms have dominated
- Debt is raised in the international project finance loan market (and then refinanced in the US debt capital markets), augmented with tax-exempt private activity bonds and TIFIA loans
- Equity increasingly raised from dedicated infrastructure funds

Commonly cited benefits and concerns in US PPP

- Optimal allocation of risk
- Accelerated delivery
- Incentivized performance
- Whole-life costing efficiencies

- Loss of control
- Inflexibility
- Pricing/regulation
- Non-domestic capital

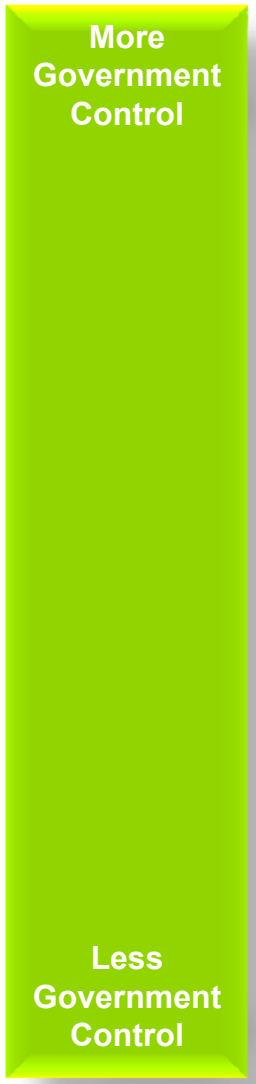
PPP Defined

There are many PPP structures but most share the following characteristics:

- **Long-term contractual arrangement with some regulatory element**
- **Designed to secure value or control costs for the public sector**
- **Private sector contractor accepts risks and responsibility for (some or all of) design, construction, maintenance and operations**
- **Public sector retains strategic control over service delivery and either cedes revenue generated from asset or makes payments for performance**

Spectrum of PPP Structures

The spectrum of PPP structures has varying risk/reward profiles for the public and private entities that must be optimally distributed between the parties



Public Ownership/Public Operation

All future control of project maintained by Government

Public Ownership & Operation /Private Design – Build

Public procurement of designed projects; Private bidding for the construction; Public ownership and operation of asset once constructed

Public Ownership / Private Management Contract

Private operator receives a (management) fee from Government based on performance and implementation of contracted services

Public-Private Joint Venture (JV)

Government retains an interest (minority) in the asset; Infrastructure asset leased to JV on a long-term basis; Transfer of control and risk negotiated between JV parties

Private Concession/Trade Sale (Long-Term Lease)

New or existing asset transferred to private entity through long-term lease (up to 99 year); Future operational and maintenance control (and risk) transferred to private entity

Full Sale of Asset/Private Ownership

All future control of project (possibly including rate setting) transferred to private entity

Choosing a structure

- Disciplined analysis to discover optimum point on the public/private spectrum
- Early decision on public subsidy – magnitude and style
- Recognizing the credit imperative
- Understanding risk capacity constraints
- Prioritizing the need for the future flexibility

DBFOM Concession – "Availability Payment" model

Public Sector Grantor

- Ownership and strategic control of assets leased to concessionaire
- Designs output specification and payment/penalty regime
- Makes regularly scheduled payments for performance
- Ongoing monitoring of compliance with Concession Agreement

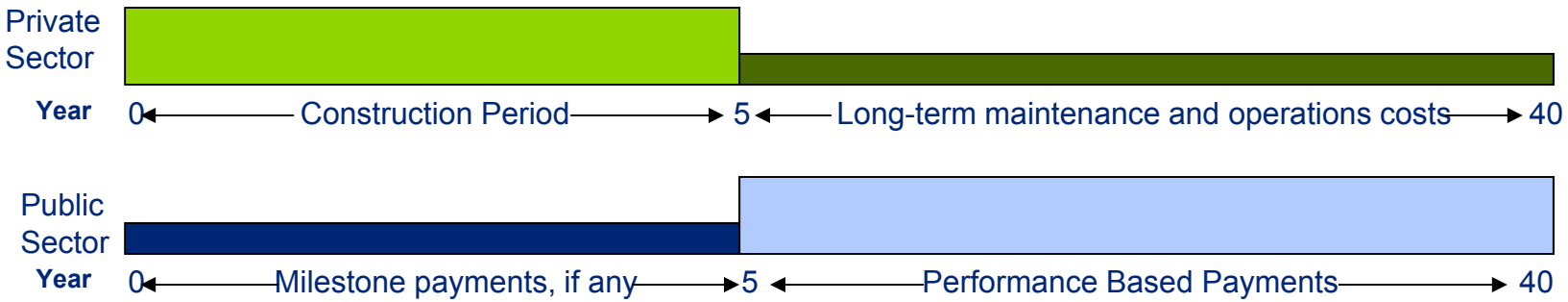
Concession Agreement

Private Sector Concessionaire

- Holder of Concession Agreement in a special purpose vehicle
- Raises capital against performance based payment system
- Designs, builds, operates and maintains facilities through competitively tendered subcontracts

Equity

Debt



Private sector appetite for Infrastructure assets

1. Predictable earnings and cashflows via regulation and/or long-term contracts
2. Monopoly characteristics
3. Attractive yield and growth
4. Low volatility of cash flows
5. Low correlation of returns vs. other asset classes
6. Experience/comfort managing financing and operational risk

Potential equity investors in US Infrastructure

Strategic Buyers/ Concessionaires

- Traditionally, operations, developers or contractors in the infrastructure sector
- Often benefit from sector operational expertise, which can enhance the value of their bids
- Increasingly becoming very aggressive bidders
- Long-term investment strategy

- Abertis
- ACS
- Acciona
- Aecom
- Bombardier
- Bouygues
- Brisa
- Cintra/Ferrovial
- FCC
- Hochtief
- Kiewitt
- Laing
- OHL
- Sacyr
- Siemens
- Skanska
- Transurban
- Veolia
- Vinci
- Zachary

Infrastructure Funds

- Private or listed equity funds focused on infrastructure investments
- Strong liquidity awaiting for investment opportunities
- Lower equity returns than for financial sponsors
- Typically look to take part in a consortium
- Medium-to long-term investment strategy
- Fund sizes are smaller than for financial sponsors

- ABN-Amro
- AIF
- Alinda Capital
- AMP Capital
- Babcock & Brown
- Borealis
- Carlyle (Infra)
- CDP
- Challenger
- CII
- CPP Investment Board
- Colonial
- Commonwealth
- General Electric
- GIP
- Goldman Sachs (Infra)
- Industry Funds Management
- JP Morgan Partners
- Macquarie
- Morgan Stanley (Infra)
- Ontario Teachers'
- Prudential
- RREEF

Financial Sponsors

- Private equity funds with shorter exit strategy
- High equity returns (+20%) may limit ability to bid competitively but have been achievable in certain opportunities
- Normally look for short term investments with a clear exit strategy
- Typically look to take part in a consortium
- Fund sizes range form $6bn to $16bn

- Apollo
- Bain Capital
- Blackstone
- Carlyle Group
- Cayton, Dubilier & Rice
- Goldman Sachs
- JP Morgan
- KKR
- MDP
- Merrill Lynch
- Providence Equity
- Thomas H. Lee
- TPG
- Warburg Pincus

The changing landscape

	Pre- "credit crisis" trends	Emerging Trends
Demand	• Fiscal good health • High construction costs • Limited public money for infrastructure • Vigorous promotion of PPPs by US DOT	• Fiscal distress • Falling construction costs • Federal stimulus package provides infusion of public money for infrastructure • Moderating emphasis on PPPs
Supply	• Highly geared capital structures and attractive equity returns • Adequate capacity in international project finance loan market and healthy debt capital markets • Dominance of active equity investors and emergence of infrastructure funds	• Lower gearing in capital structures resulting from ratings constraint leads to declining equity returns • Limited capacity in international project finance loan market and challenged debt capital markets • Impairment of some active equity players balanced by continued growth in infrastructure funds